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No. 82-

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1982

EMI LIMITED,
Petitioner,

VS.

WILLIAM BENNETT, KENNETH CORY, MARY ANN GRAVES, and GERALD H. GOLDBERG.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT PRIOR TO ENTRY OF DECISION IN THAT COURT AND WHILE CASE IS PENDING THEREIN

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QUESTIONS PRESENTED

1.a. Whether a United Kingdom corporation which has no place of business in the United States, which has no access to the State courts, and which owns an American subsidiary, has standing to sue in the Federal courts for the following relief:

(1) To restrain defendant state tax officials from making further demands on plaintiff, either directly or through pressure on its American subsidiary, for financial information about its operations in other countries which it cannot provide either because the law of the home country prohibits it or because local records of foreign subsidiaries do not segregate it and make it available to plaintiff; and

(2) To restrain defendant state tax officials from assessing a tax on plaintiff's American subsidiary based on the disregard of plaintiff's separate entity, and on the apportionment of plaintiff's income entirely earned abroad to California to tax to that subsidiary, where the economic effect of defendant's conduct is to diminish the value of plaintiff's property in the United States, all contrary to a treaty, to international law, and to the United States Constitution.

b. Whether the relief sought can be granted by a Federal court, where plaintiff has no access to State courts, and the rights plaintiff is suing to enforce are created entirely by Federal sources of law; viz., a treaty, the United States Constitution makes obligatory on the states.

c. Whether the Federal courts can refuse to entertain a case or controversy under International Law and under the Due Process Clause of the Fifth Amendment where the State courts provide no remedy and the rights sought to be enforced are created by the United States Constitution, a treaty to which the United States is a party, and International Law.

d. Whether the Federal courts have subject matter jurisdiction over a case involving asserted violations of a United States treaty, the United States Constitution, and International Law.

It is not contended that this issue is the one which justifies intervention of this Court prior to decision in the Court of Appeals under the standards explained in Rule 18 of the Rules of this Court.

2. Does international custom recognized as such by the Executive and observed by the Federal Government in its own tax system bind the States of the Union or only the Federal Government?

3. May the State of California burden foreign commerce by extending its combined unitary income formula (hereinafter "combined formula") to a United Kingdom corporation which has foreign commerce with the United States but which does no business in any state of the United States, which does not have a permanent establishment in the United States, which is not subject to taxation by the United States Government under either the Internal Revenue Code or the United States-United Kingdom Income Tax Convention, and where the

effect of the State's application of its formula is to apportion income of the non-resident United Kingdom corporation and its non-United States subsidiaries to the American subsidiary for taxation by California where:

a. The entire income of the United Kingdom corporation and of its non-U.S. subsidiaries has already been taxed in full by the United Kingdom and the other host countries, and California allows neither a deduction for those taxes nor a credit for them against its own tax, thus producing multiple taxation of income earned in foreign commerce; and

b. The income of the American subsidiary is swollen by that apportionment far beyond any conceivable earning capacity of its own business; and

c. The apportionment of the combined net income by the three-factor formula of the ratio of California property, payroll and sales to the combined world-wide property, payroll and sales of the United Kingdom parent and its non-U.S. subsidiaries, is made on the basis of estimates, first because the Official Secrets Act of the United Kingdom prohibits the United Kingdom corporations from revealing some of the information essential to the application of the California formula, and second because the wages paid by the non-U.K. subsidiaries are not reported to the United Kingdom parent and are for years before California made its demand and cannot now be assembled; and

d. There is no uniformity between the economic environment in which the American subsidiary operates

and those in which the non-U.S. corporations operate, most notably because the wage rates in the United States for the years before the Court were higher than those prevailing in any other country in which the corporations which California would consolidate operate, with the result that each factor in the formula is weighted to apportion more net income to California than could be earned in that state by the business conducted in it, such income being therefore derived from that properly taxable by the United Kingdom and the other foreign countries where the businesses are conducted; and

e. Where the businesses of the United Kingdom parent, its non-U.S. subsidiaries, and the American subsidiary which are being combined consist primarily of making records and tapes in each country of music popular in that country, and the sale of those records and tapes to the residents of that country, but sales of records in foreign commerce are made by both the U.K. parent and the American subsidiary to customers of their choice, and under a reciprocal matrix exchange agreement both the U.K. parent and the American subsidiary make records of music initially recorded by the other; and

f. Where the effect of the California formula is to tax to the American subsidiary income earned and received exclusively abroad by other corporations from business conducted locally in other countries or in foreign commerce which income California would not have jurisdiction over directly because of the Due Process Clause, of International Law, and

of the United States-United Kingdom Income Tax Convention.

4. Does the United States-United Kingdom Income Tax Convention in effect in the years 1968-1974 prohibit a state's apportioning by formula to an American subsidiary some of the income of its United Kingdom parent corporation where under the treaty the United States cannot tax any of the income of the United Kingdom parent because it does not have a permanent establishment in the United States?

PARTIES TO THE PROCEEDING BELOW

There is no other party to this proceeding. Capitol Industries-EMI, Inc., plaintiff's subsidiary, is a party to a companion but unconsolidated case which was joined in the Court of Appeals for argument and decision, and which is pending before this Court on petition for certiorari in Docket No. 82-688. It will be affected by the outcome of this case.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT PRIOR TO ENTRY OF DECISION IN THAT COURT AND WHILE CASE IS PENDING THEREIN

EMI Limited, a corporation of the United Kingdom, plaintiff in the United States District Court and appellant in the United States Court of Appeals for the Ninth Circuit, petitions for a Writ of Certiorari under Rule 18 of this Court to review the case now pending in and not yet decided by the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

There is no opinion of the Court of Appeals. The opinion of the District Court is not officially reported, but is appended hereto in Appendix A. The opinion of the Court of Appeals at a prior stage of these proceedings is reported at 681 F.2d 1107. The portion of it relevant to this petitioner is reproduced in Appendix B hereto.

JURISDICTION

The jurisdiction of this Court is invoked under Sections 1254(1) and 2101(e) of Title 28, United States Code. No decision has yet been rendered by the United States Court of Appeals, in this appeal, which was docketed November 2, 1982. The decision of the District Court, Northern District of California, dismissing the case, was entered on October 8, 1982, and Notice of Appeal was filed by petitioner on October 21, 1982.

The jurisdiction of the federal court was invoked under Sections 1331 and 2201, Title 28, United States Code. Plaintiff has no judicial remedies available to it in the California courts under California statutes and constitution, and for that reason the Court of Appeals held that the provisions of Section 1341, Title 28, United States Code, do not remove this case from the jurisdiction of the federal courts. The dismissal on remand was based on the assertions that petitioner lacks standing to sue, and the federal courts lack jurisdiction of the subject matter. Appendix A.

STATUTES, CONSTITUTIONAL PROVISIONS AND TREATIES INVOLVED

1. The sections of the Judicial Code involved are Sections 1331 and 2201, Title 28, United States Code. They are set forth verbatim in Appendix C.

2. The sections of the United States Constitution involved are the Commerce Clause (Art. I, Sec. 8, cl. 3), the Due Process Clause (amendment 14, Sec. 1), the Import-Export Clause (Art. I, Sec. 10, cl. 2), and Art. I, Sec. 8, cl. 1 and 10, and Art. I, Sec. 10, cl. 1 and 3; and Art. II, Sec. 2, cl. 1 and 2, Art. III, Sec. 2, cl. 1 and 2, and Art. VI, cl. 2 and 17. All are set forth in Appendix C.

3. The United States-United Kingdom Income Tax Convention in effect in the years involved in this case. The text of the relevant provisions is set forth in full in Appendix D.

STATEMENT OF THE CASE

This case is one to restrain defendant California State tax officials from assessing a tax against petitioner's subsidiary, Capitol Industries-EMI, Inc., on a portion of petitioner's income from its business done exclusively in foreign and local commerce from and in the United Kingdom, in violation of International Law, a federal treaty, and the United States Constitution.

Petitioner, EMI Limited, is a corporation formed in the United Kingdom, which owns all or substantially all of the stock of 76 subsidiary corporations, some of which are formed under the laws of the United Kingdom, and others of which are formed under the laws of the various countries in which they operate. They operate in and are formed under the laws of more than 30 countries in Western Europe, North America, the Near East and the Far East of Asia, South America, South Africa, and Australasia. Capitol Industries-EMI, Inc. is one such subsidiary, and has been since plaintiff acquired a majority of its stock in 1956. Capitol Industries-EMI, Inc. (hereinafter "Capitol") is formed under the laws of the United States, has its principal office and plant in Hollywood, California, and has other plants in Illinois, Virginia and Connecticut.

EMI Limited does not do business in the United States and does not have a permanent establishment in this country. By treaty it is exempt from United States tax. In its corporate self it does no business outside of the United Kingdom. EMI's worldwide subsidiaries make approxi-

mately 20% of all of the phonograph records made in the Western world, and own pressing plants located in 13 countries. Three of these plants are in the United States, owned by Capitol. In addition to that type of music business, through subsidiaries operating in several countries, but not in the United States, the EMI group is in the business of retailing phonograph records and pre-recorded tapes, and sheet music.

Subsidiaries of EMI also operate a variety of other businesses: the manufacture of television cameras, antennae and transmission equipment, and of security devices; the operation of a movie studio at which both television films and films for the theater are made; the operation of movie theaters, bingo parlors, hotels, restaurants, and places of amusement; the manufacture for the government of the United Kingdom and certain governments of NATO of military equipment, much of which employs radar principles pioneered and in some instances invented by EMI; and the development and production of equipment in the field of medical electronics, the most notable of which is the invention and patenting of the brain scanner and body scanner. Capitol conducts no business other than the making of phonograph records and pre-recorded tapes, and at times the manufacture and sale of raw tapes for use by other recording companies.

Defendants demanded information of EMI Limited, threatening it with monetary penalties if it did not reply. EMI informed them that it was not within the jurisdiction of California, could not supply some of the information sought because of restrictions of the Official Secrets Act of the United Kingdom, and did not possess other of the information sought because it was not supplied to EMI by

EMI's non-U.K. subsidiaries. Defendants then made the same request for information of Capitol, with the same threat of a penalty, and Capitol informed defendants that it could not supply information about EMI which it could not get from EMI. Defendant's staff then compiled figures about EMI available from public sources in the United States, and assessed a proposed additional tax against Capitol based upon what they believed to be the total net income of EMI and all of its worldwide subsidiaries, and an apportionment of it to California based upon the ratio which the California property, payroll and sales of Capitol bore to what defendants estimated was the total worldwide property, payroll and sales of EMI and its subsidiaries. The non-U.K., non-U.S. property and payroll figures were unknown and defendants substituted their estimates. Capitol protested this action, conferences were held by Capitol representatives with defendants and their representatives, and those representatives informed Capitol that defendants would adhere to their position, until such time as Capitol provided the information defendants had sought from EMI. Petitioner EMI Limited and Capitol both then filed cases in the United States District Court for the Northern District of California against the defendants, to restrain such an assessment against Capitol, and in EMI's case to restrain defendants from demanding of EMI, either directly or through Capitol, information it was prohibited by British law from revealing, from lessening the value of EMI's property in the United States through the assertion of unconstitutional taxes from Capitol, and from burdening EMI's foreign commerce with the United States.

Cross-motions for summary judgment were filed, in petitioner's motion supported by extensive affidavits of officers

of EMI and Capitol, and documentary exhibits. While these cases were pending in the United States District Court, defendants' representatives proposed to Capitol's representatives that defendants would change the basis of assessment, to combine Capitol only with EMI's music business. Capitol's representatives informed defendants' representatives that the information they needed for such a modified combination and apportionment was not available under British law, so the representatives of defendants devised figures based upon assumptions and estimates and employed those in the apportionment formula in substitution for the figures that they had previously used which had represented the entire worldwide business of petitioner. The effect was to reduce the deficiency, but a substantial deficiency in excess of $800,000 still remains in issue for the years determined by defendants, and an unknown but certain amount for later years.

The District Court rendered summary judgment for defendants, holding that for purpose of Section 1341, petitioner, although not having any judicial remedy in the California courts, must be deemed to have the remedy California law afforded to Capitol. Appeal was taken, and the Court of Appeals held that petitioner had no remedy in the California courts and Section 1341 did not bar it from the federal courts. It remanded the case to the District Court, which refused to rule on the merits and dismissed the case, this time on the grounds that petitioner lacked standing to sue, and that the federal courts lacked jurisdiction of the subject matter. This appeal followed.

This petition before judgment below is filed to enable this Court, if it so desires, to add a case involving a foreign parent in a multi-national group of corporations with

American subsidiaries to those cases which it will consider, *Container Corp. of America v. Franchise Tax Board*, No. 81-523, and *Chicago Bridge and Iron Co. v. Caterpillar*, No. 81-349. Those cases involve the Constitutional validity of combining domestic parents with their foreign subsidiaries and the apportionment of the income of the latter to the domestic parents. The instant case presents the converse, where the parent is a foreign corporation and the effect of the combination is to attribute its foreign source income downstream to the domestic subsidiary. As the amicus brief of the Solicitor General in No. 81-349 states, at p. 18, this type of case presents the violation of international custom and the burden on foreign commerce in the clearest focus.

Petitioner does operate in foreign commerce between the United Kingdom and the United States. Its subsidiaries sell completed phonograph records to a United States outlet, but not to Capitol. It and its subsidiaries have a matrix exchange agreement with Capitol, modeled closely after the one which EMI Limited had with RCA before EMI acquired controlling interest in Capitol, under which each party has an option to license a duplicate matrix of recordings made by the other, to make recordings of the music embedded on that matrix and to sell them in their marketing areas. This agreement is entirely reciprocal, giving EMI precisely the same rights in respect of matrices of music recorded by Capitol as it gives Capitol for matrices made by EMI. The agreement confers an option right on each party, and does not bind either party to take any of the matrix offerings of the other. The license fees and other amounts paid for the privilege are entirely reciprocal, so that the amounts paid by Capitol to EMI are the same as the amounts paid by EMI to Capitol, per unit manufactured.

Petitioner contends that taxing Capitol on an apportioned amount of EMI's income represents a forbidden burden on foreign commerce, contrary to the Constitution of the United States, and contrary to international law, and to the United States-United Kingdom Income Tax Convention.

Petitioner contends that it is not engaged in a single unitary business with Capitol, and that the income of each can be readily ascertained by the arm's length method used by the United States Government under Section 482 of the Internal Revenue Code, and by all foreign governments.

REASONS FOR GRANTING THE WRIT

1. This Court has accepted jurisdiction of two cases[1] presenting the constitutional issues raised by the application of their combined apportionment formulae by states to foreign source income of foreign subsidiaries of domestic parent corporations. The urgency of this case is that it presents another, and vitally important, aspect of the same problem: viz, the application of such combined apportionment formulae to the foreign source income of foreign parent corporations with an American subsidiary. This aspect of the problem should be considered while the Court is considering the other cases. Considerations unique to the foreign parent, such as treaties, double taxation of the before-tax income, and the fact the foreign source income of foreign parents will never be paid into the United States, and will never be within the reach of the United

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[1] *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., Illinois Department of Revenue*, No. 81-349; and *Container Corporation of America v. Franchise Tax Board*, no. 81-523.

States, are considerations the Court should have presented to it on plenary argument, and will not have before it in cases involving American parent corporations. The amicus brief filed by the Solicitor General in No. 81-349 presents some of these arguments and acknowledges (p. 18) that they are involved with full force in a case such as this one, in which a state is attempting to force the foreign source income of a foreign parent downstream to its American subsidiary, and tax the latter on it.

2. The Court has been made aware by the Solicitor General's brief and the other amicus briefs in Nos. 81-349 and 81-523 that there is no more serious international controversy involving the United States in the area of taxation than that which has been engendered by the insistence of certain states on applying their combined unitary apportionment formulae to foreign-based multinational corporations and their foreign subsidiaries, and then combining them with their American subsidiaries. The Court has been informed repeatedly that three Presidents of the European Economic Community have filed protests with the Department of State against this practice. The Governments of the United Kingdom, Canada and the Netherlands have filed letters of protest with the Department of State. Members of Parliament of the United Kingdom have gone so far as to testify before a Congressional Committee in Washington in support of bills which would prohibit states' including foreign source income of multinational corporate groups owned by foreign corporations within their unitary apportionment formulae. All of these letters were written to the Department of State after the United State Senate refused, by two votes less than the two-thirds

required for approval, to approve the explicit prohibition of such practice in the new United States-United Kingdom Income Tax Convention.

3. The International community has shown much more concern with the avoidance of duplication of income taxes than it has with the duplication of property taxes. There are presently 40 such treaties either in effect between the United States and foreign nations or signed and in the process of ratification. There are many more than that in effect bilaterally between other nations. International organizations have model tax treaties all containing procedures for avoiding duplication of income taxes. The concern this Court expressed in *Japan Line, Ltd. v. County of Los Angeles,* 41 U.S. 434 (1979), about duplication of taxation in foreign commerce and the retaliatory effect that could be expected from permitting a state to impose taxes on foreign commerce which duplicate the tax burden imposed by the home nation, should be even greater here. The duplication of income taxation in the international sphere is an issue of much bigger international importance than was the duplication of property taxes this Court disapproved in *Japan Line.* As we will show hereafter, the retaliation which this Court foresaw would follow from the duplication of tax involved in *Japan Line,* if this Court had permitted it to occur, has already occurred in the international income tax sphere. The EMI Limited case and its companion case, Capitol Industries-EMI, Inc. v. Bennett, et al., No. 82-688, October Term 1982, are excellent vehicles for the consideration of the impact of this type of combined formula because the feared duplication of tax exists in fact, and the ultimate equity owner of the income which has been taxed twice is a foreign corporation, formed

under the laws and operating in a treaty nation, and having no permanent establishment in the United States. The impact of any decision in this area involving domestically-owned multinational corporate groups cannot be fully assessed by this Court without consideration of the possible impact of such a decision on foreign parents of multinational groups which have one or more subsidiaries operating in the United States.

The State of California has argued in its brief filed in No. 81-523, at pp. 116-118, that the international prohibition of duplication of taxes cannot apply to state taxes because it is accepted custom within the United States for both the federal government and the states' governments to tax the same income. That argument misses the entire point of the international custom. By bilateral treaties where they are in effect and international custom where they are not, the foreign countries have pledged themselves to abstain or do in fact abstain from demanding tax contributions to run their own governments from income which has paid a tax in another country. The United States cannot escape the same obligation by resort to the division of governmental expenditures between federal and state governments. The United States is responsible internationally for the conduct of its states, and is the government which is regarded internationally as the responsible government for providing governmental services in the United States. If it chooses to delegate some of them to political subdivisions it may, but it cannot thereby avoid restrictions against the double taxation of income by expecting foreign governments to tolerate doubly taxing income to support the political subdivisions of the United States of America.

4. International law prohibits what defendants seek to do, this Court should so declare, and in this case can do so. Unlike the situation in the *Japan Line* case, here there is an entire absence of nexus. Petitioner has no property of its own or office in California. Under International law ownership of the stock of Capitol does not establish the presence of petitioner in every State in which Capitol operates. International law is based on custom and settled practice as much as on multilateral treaties and agreements. *Sears v. The Scotia,* 14 Wall (81 U.S.) 170 (1872); *The Paquete Habana,* 175 U.S. 677, 686, 708 (1900); Statute of the International Court of Justice, Sec. 38(1); Statute of the World Court, Sec. 36; Restatement of the Foreign Relations Law of the United States, Second, Sec. 1, Comment C. Every state is subordinate to International law. *Banco National de Cuba v. Sabbatino,* 376 U.S. 398, 425 (1964). The international custom to respect the distinction between foreign parent and domestically formed subsidiary is so thoroughly accepted that it is in each of the forty income tax treaties the United States has signed and in addition is universally respected between nations where there is no treaty. Thus, for example, Mexico and the United States, and Colombia, Venezuela, Peru, Chile and Spain, and the United States, all recognize the custom in the absence of treaty. Thus under International Law California's jurisdiction over Capitol does not confer jurisdiction over petitioner.

The official position of the Executive about what is prevailing international custom binds the American courts (Draft Restatement of Foreign Relations Law (Revised) American Law Institute, Sec. 132(3)). The Solicitor General's amicus brief in No. 81-39 is an expression of the

Executive's position. Before that, in 1977, both Secretary of the Treasury Blumenthal and Assistant Secretary Woodworth testified before the Senate Foreign Relations Committee that the California combined unitary apportionment method was contrary to "the internationally accepted approach" and "is inconsistent with accepted tax treaty policy." (Hearings Before the Senate Foreign Relations Committee, July 19, and 20, 1977, 95th Cong. 1st. Sess. pp. 20-21, 412, 489-490.)

Notes from the Governments of the United Kingdom, Canada and The Netherlands, and from three Presidents of the European Economic Community to the United States Department of State, have spoken of the competing allocation method required by all treaties in force, known as the arms-length basis, as the internationally accepted basis, and have protested California's departure from it.

The importance of this Court's early review of California's departure from International law, in conjunction with the two cases it is reviewing, and presenting the situation the Solicitor General has stated presents the international issue in its clearest form, justifies the Court's review of this case at this time.

5. The action defendants would take is in violation of the treaty then in effect. While it seems not to be a model of clarity to eyes accustomed to distinguishing between state and federal governments, it must be read as an international document speaking for two nations indivisible. The treaty contains clear indications that the treaty binding "the United States" was intended to bind all 50 of them. The treaty language was intended to be understood on both sides of the Atlantic, and in diplomatic usage "State" means "nation". The treaty refers repeatedly to

corporations "created or organized in or under the laws of the United States". All American private business corporations are organized under the laws of some State, so the term "United States" is clearly used to include the states, and if that meaning is applied throughout defendants are in violation of the treaty. Petitioner does not have a permanent establishment in the United States and is exempted by the treaty from taxes imposed by "the United States of America."

6. In *Japan Line, Ltd. v. County of Los Angeles, supra*, this Court predicted that foreign governments would be driven to retaliate against the United States if American states were permitted to impose a duplicating tax on property already, and properly, taxed in the home country. California's tax practices typified by what defendants are seeking to do here have already produced retaliation by the United Kingdom. The new U.S.-U.K. Income Tax Convention as signed, and approved by the British Parliament, contained an express prohibition of states' combined formulae as applied to United Kingdom parents and their American subsidiaries. The United States Senate approved the treaty except for that provision, which narrowly failed to obtain two-thirds approval. This required that the British Parliament ratify the treaty without that provision, which for two years it refused to do. It insisted on another revision, the Third Protocol (see Appendix E), which had the effect of permitting increases in the taxation of American corporations operating in the British North Sea. This retaliatory effect is not confined to California's corporations.

There is no assurance other countries will not also retaliate against the California combined formula. There are

nine members of the EEC who joined in the denunciation of the California practice. Since one has already retaliated, it is reasonable to expect others to do so. Certainly the danger this Court foresaw if the States are free to impose multiple tax burdens on foreign commerce is present here, and this Court should review the permissibility of the California method of measuring its tax on domestic subsidiaries by the foreign source income of their foreign parents as soon as possible.

This case provides a suitable vehicle.

7. The decision of the District Court concerning jurisdiction does not present an issue which would cause this Court to review that decision before consideration in the Court of Appeals, but this Court cannot well grant certiorari on the merits of our petition unless it believes that it has jurisdiction to do so. Hence we argue the jurisdictional point.

The District Court apparently understood the opinion of the Court of Appeals as instructing it to dismiss, although the Court of Appeals had not considered the point on the merits, said so, and even refused to permit petitioner to file a post-argument brief on the point, which had not been discussed in the previous briefs. The standing to sue objection is wholly without merit.

First, the District Court relied on a number of prior decisions by the Court of Appeals for the Ninth Circuit which that court had referred to in remanding the case for consideration of the issue, to the effect that ordinarily a parent corporation does not have standing to sue to object to what is being done to its subsidiary. There is neither logic nor justice in permitting that analysis to prevail in a case such

as this one, where the complainant is suing to prevent the defendants from disregarding the complainant's corporate entity. The state tax officials are disregarding petitioner's corporate entity in allocating some of its net income to Capitol for taxation to that corporation. The income of petitioner is not the income of Capitol, unless the corporate entity of petitioner is disregarded, or unless Capitol's corporate entity be disregarded and its operations deemed to be those of petitioner. The latter contention has never been made, but if it were it would make EMI the principal and end the standing to sue debate. Where the merits of the case present the propriety of the disregard of petitioner's corporate entity, it cannot be said that petitioner is without standing to sue to prevent it. A cynical disregard of justice would be carried to the extreme if the doctrine of corporate entity prevents a parent corporation from suing to prevent defendants from disregarding the parent's corporate entity.

Secondly, petitioner has standing to sue based upon its own claim for relief. The first claim for relief is that petitioner's property in the United States would be diminished in value if defendants are permitted unimpeded to do what they are attempting to do. Petitioner thus suffers directly an economic detriment which it seeks to prevent. The fact that petitioner's property is stock in a corporation instead of tangible personal property, or a bank account, or land, should not alter the fact that the stock it owns in Capitol is petitioner's property, and defendants are seeking to diminish its value by asserting an unconstitutional tax against it. The complainant's capacity to assert a case or controversy does not depend on the type of property which defendants would burden. Threatened injury to any property gives its owner the "personal stake in the outcome," thus providing "that concrete adverseness which sharp-

ens the presentation of issues . . ." *Baker v. Carr*, 369 U.S. 186, 204 (1962). The added requirement of causal connection between the threatening conduct and the injury (*Duke Power Co. v. Carolina Env. Study Grp.*, 438 U.S. 59, 72) is abundantly present, and is significantly clearer than it was in *Duke Power*. Petitioner's standing is based on a present ownership of threatened property, not one contingent on future events, yet even such a contingent economic stake can confer standing to sue. *Bryant v. Yellen*, 447 U.S. 352 (1980).

Furthermore, petitioner seeks relief to prevent defendants from continuing to make demands on it and its subsidiary that it violate British law in order to supply them with information beyond their jurisdiction to obtain directly. The Court of Appeals stated in a footnote in its remanding opinion that only one demand was made against petitioner and the rest of the demands were made against Capitol. We do not see why that should effect the result adversely to petitioner, since clearly defendants were seeking to use economic pressure on petitioner's property to force petitioner to supply information to them it could not supply under penalty of violation of British law.

Freedom from demands for information was held to confer standing to sue in *United States Steel Corp. v. Multi-State Tax Commission*, 367 F.Supp. 107 (S.D.N.Y. 1973, affirmed on other grounds 434 U.S. 452). This is the landmark case which upheld the constitutional validity of the Multi-State Tax Commission. If this court had disagreed with the views of the District Court that United States Steel had standing to sue to object to the demands on it for information it is unlikely this Court would have used such a case for the establishment of such a landmark principle.

In any event, the standing to sue to make that objection seems self-evident.

Finally, only petitioner has the certain and clear right to sue to enforce the United States-United Kingdom Income Tax Convention. The damage to it through violation of that treaty is a reduction in the value of its property in the United States attributable to the defendants refusing to comply with the treaty. Their conduct in taxing Capitol on EMI's income is a violation of the treaty, in petitioner's eyes, and is part of petitioner's case in the Federal courts.

Finally, the spectacle we would be presented with if the District Court should be affirmed would be that a foreign corporation, aggrieved by conduct of American officials, has no judicial remedy available to it in the United States. The State courts provide no relief because they provide no remedy for this petitioner, as the Court of Appeals held on the first appeal, and the District Court has held that the Federal Courts provide no remedy either. Yet international law obligates the United States to provide a forum for the protection and enforcement of treaty rights and other rights which international law recognizes. See Restatement of the Foreign Relations Law of the United States (Draft Revision), Sec. 711, comment a; Sec. 713, comment a. This rule was pointed out to the District Court in the brief filed there but was ignored.

Moreover, aliens are entitled to procedural due process under the Fifth Amendment (*Wong Wing et al. v. United States*, 163 U.S. 228 (1896), and a federal statute should not be interpreted to challenge that rule (*Russian Volunteer Fleet v. United States*, 282 U.S. 481 (1931)). By parallel reasoning, a judicial interpretation of the case or contro-

versy requirement should not lead to a denial of any American forum, since that result would deny procedural due process.

The further ruling of the District Court that it lacked subject matter jurisdiction of an action arising under a United States treaty, the United States Constitution and international law is incomprehensible, is erroneous, and should be disapproved.

CONCLUSION

This case represents the vehicle for this Court's consideration of the constitutional status, under the United States Constitution and International Law, of the combined unitary formula used by California and certain other states, where the parent corporation and most of the included corporations are foreign corporations, and a domestic subsidiary is combined with them, providing the state with the opportunity to assert the right to apportion some of their income to itself to tax. None of the foreign corporations has a permanent establishment in the United States, and a mathematically determined percentage of the total income of the group is assigned to the domestic subsidiary for taxation, without regard to the absence of any overreaching or other conduct which could have the effect of improperly shifting income from the subsidiary to the foreign sources, and to the fact any irregularities could be adequately dealt with by the internationally accepted arm's-length method. This case would expand the scope of this Court's consideration of the *Container Corporation of America v. Franchise Tax Board*, No. 81-523, to include a domestic subsidiary of a foreign parent, and thus provide the Court with a vehicle suitable for considering fully the

objections of the foreign nations to California's departure from established international custom, and California's double taxation of income already fully taxed in the host or parent country.

We believe the procedural objections the District Court found should not deter the Court, because standing to sue is plainly present on the facts and under this Court's prior decisions, and subject matter jurisdiction is clearly present.

Accordingly, the Writ of Certiorari should be granted.

Respectfully submitted,

Valentine Brookes,
Counsel of Record

Brookes and Brookes
Attorney for Petitioner

(Appendices follow)

Appendix A

No. C-79-2146 SC

United States District Court
Northern District of California

EMI Limited,
Plaintiff,

vs.

William M. Bennett, et al.,
Defendants.

[Filed October 8, 1982]

ORDER GRANTING MOTION TO DISMISS

This case is before the court on defendants' motion to dismiss for lack of subject matter jurisdiction. The case has a lengthy history. Plaintiff EMI Limited ("EMI"), a United Kingdom corporation that does no business in California, is the parent corporation of Capitol Industries-EMI, Inc. ("Capitol"), a Delaware corporation with its principal place of business in California. Defendants are members of the California Franchise Tax Board.[1] In separate but related actions EMI and Capitol challenged the tax deficiency assessed against Capitol by the Franchise Tax Board. The assessment was made according to California's unitary method. *See* Cal. Rev. & Tax. Code §§ 25101, 25120-25138. The district court granted summary judgment in both cases in favor of defendants pursuant to 28 U.S.C. § 1341 (anti-injunction statute) on the ground that EMI and Capitol had a plain, speedy, and adequate state law

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[1]The current members of the Franchise Tax Board have been substituted as defendants. *Capitol Industries-EMI, Inc. v. Bennett*, 681 F.2d 1107, 1111 n. 8 (9th Cir. 1982).

remedy. On appeal, the Court of Appeals for the Ninth Circuit ordered that Capitol's action be dismissed for lack of subject matter jurisdiction. In addition, it reversed the judgment against EMI and remanded for further proceedings. *Capitol Industries-EMI, Inc. v. Bennett,* 681 F.2d 1107 (9th Cir. 1982). Pursuant to a suggestion made by the Court of Appeals, *id.* at 1119 n. 31, defendants have now moved to dismiss for lack of standing, and generally for lack of subject matter jurisdiction.

EMI alleges that computation of Capitol's tax according to California's unitary method violates the United States Constitution and the United States-United Kingdom Income Tax Convention. No assessment has been made against EMI, only against Capitol. EMI alleges that the assessment injures it because, as majority shareholder, the value of its investment will decrease if Capitol must pay the tax. EMI also alleges that the Franchise Tax Board has requested it to supply certain information and has threatened to assess a penalty against it if it does not.

Although an injury to a corporation may indirectly harm a shareholder by decreasing the value of his shares, that fact does not give the shareholder standing to sue on his own behalf. The primary injury and the primary right to sue are the corporation's; the shareholder may sue, if at all, only in a proper derivative action. *Von Brimer v. Whirlpool Corp.,* 536 F.2d 838, 846 (9th Cir. 1976); *Erlich v. Glasner,* 418 F.2d 226, 227-28 (9th Cir. 1969); *Papilsky v. Berndt,* 466 F.2d 251, 255 (2d Cir.), *cert. denied,* 409 U.S. 1077 (1972); *Jensen v. Voyles,* 393 F.2d 131, 133 (10th Cir. 1968). Therefore, EMI's claim of dimunition of its investment is not sufficient to confer standing.

EMI also claims that the tax violates the United States-United Kingdom Income Tax Convention. The provisions EMI relies on set forth conditions under which United Kingdom corporations and their subsidiaries may be taxed in the United States. The treaty does not help EMI here. EMI is not being taxed, and the provisions regarding taxation of subsidiaries create rights, if at all, only in favor of Capitol. The treaty makes no mention of a right of action by a shareholder as such.

EMI asserts that the demands for information made by the Franchise Tax Board support standing. To show that such demands were made, EMI relies primarily on a letter received from the Board stating what information it needed. EMI claims that the Board does not have jurisdiction over it and that under United Kingdom law it cannot supply the information.

It must be noted at the outset that the demands for information would not necessarily support standing to challenge the tax assessed against Capitol, but perhaps only a more limited standing to challenge the Board's right to obtain information from EMI. Further, the Court of Appeals determined that the demands for information were addressed to Capitol, not EMI. *Capitol Industries-EMI, Inc. v. Bennett,* 681 F.2d at 1119 n. 30. The record on appeal contained essentially the same information EMI now relies on.[2] Affidavits before the Court of Appeals discussed the information requests allegedly made of EMI and the specific letter EMI relies on here. EMI may not continue to

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[2]On a motion to dismiss for lack of subject matter jurisdiction it is proper to look to matters outside the pleadings. *Id.* at 1118 n. 29.

make the same assertions on the same evidence. Therefore, the alleged information demands do not support standing.

In sum, neither EMI's status as controlling shareholder of Capitol nor the United States-United Kingdom Income Tax Convention confer standing to challenge the tax assessed against Capitol. The asserted demands for information also do not support standing, even for more limited claims. Therefore, this court lacks subject matter jurisdiction.

In accordance with the foregoing, it is hereby ordered that defendants' motion to dismiss for lack of subject matter jurisdiction is granted.

Dated: October 8, 1982.

/s/ SAMUEL CONTI
United States District Judge

Appendix B

No. 80-4113

DC No. C79-2145-CBR

In the United States Court of Appeals

For the Ninth Circuit

Capitol Industries-EMI, Inc.,

Plaintiff-Appellant,

vs.

William M. Bennett, Kenneth Cory, Richard Silberman, individually and as members of, and Martin Huff, individually and as Executive Officer of, The Franchise Tax Board, State of California,

Defendants-Appellees.

No. 80-4114

DC No. C79-2146-CBR

EMI Limited,

Plaintiff-Appellant,

vs.

William M. Bennett, Kenneth Cory, Richard Silberman, individually and as members of, and Martin Huff, individually and as Executive Officer of, The Franchise Tax Board, State of California,

Defendants-Appellees.

OPINION

[Filed Feb 16, 1982]

On Appeal from the United States District Court

For the Northern District of California

Charles B. Renfrew, District Judge, presiding

Argued and Submitted October 15, 1981

Before: WALLACE and PREGERSON, Circuit Judges, and BYRNE,* District Judge

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*The Honorable Wm. Matthew Byrne, Jr., United States District Judge for the Central District of California, sitting by designation.

BYRNE, District Judge:

This appeal involves two companion cases brought by an United Kingdom corporation and its United States subsidiary corporation, respectively, for injunctive and declaratory relief to prevent officials of the State of California from assessing additional income taxes against the subsidiary.

I

Appellant in the first action (No. 80-4113), Capitol Industries-EMI, Inc. ("Capitol"), is a Delaware corporation, with its principal place of business in California. Capitol is in the business of recording phonograph records and tapes for sale through commercial channels. Capitol contends that its business is conducted almost exclusively in the United States.

Appellant in the second action (No. 80-4114), EMI, Limited ("EMI"), is a United Kingdom corporation, which owns more than 70% of the stock of Capitol.[1] EMI owns a group of subsidiaries, fourteen of which operate outside of the United Kingdom. EMI, through its subsidiaries other than Capitol, is engaged in the same business as Capitol, but primarily in markets other than in the United States. In addition, EMI and its foreign subsidiaries, other than Capitol, are engaged in diversified businesses unrelated to the recording industry.

In the seven years involved in this tax dispute, 1968-1974, Capitol has paid annual income taxes in California.[2] Neither EMI nor its subsidiaries, other than Capitol, have filed

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[1]According to appellees, EMI owns more than 70% of the stock of Capitol. According to appellants, EMI owns more than 90% of the stock of Capitol.

[2]In the seven years involved in this dispute, Capitol has made annual self-assessed state franchise tax payments averaging $88,841.68.

any income tax returns with the United States or any state therein. However, EMI and its other subsidiaries have paid income taxes in their respective home countries.

The Franchise Tax Board, State of California ("FTB"), contends that California law requires a combined report of a taxpayer, including all commonly owned or controlled corporations that are engaged in a unitary business. The FTB has determined that Capitol, EMI and other EMI subsidiaries are engaged in a single business. Therefore, the FTB has proposed to assess against Capitol an additional tax liability for the seven years in question, based on the state's "unitary method" of taxation.[3] It is this proposed assessment that Capitol and EMI challenge.

Application of the unitary scheme under California law, as proposed by the FTB, involves the combining of the net incomes of Capitol, EMI, and all of EMI's other subsidiaries, related to the music portion of their businesses, and the apportioning of that combined income between California and the rest of the world, based on a formula using the Cal-

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[3]According to materials submitted by the parties subsequent to oral argument on appeal, the FTB has adjusted the proposed additional assessments against Capitol to reflect its determination that the unitary business in which Capitol and EMI are involved encompasses only the "music activities" of the "EMI group." In addition, the proposed assessments were adjusted to reflect agreements between Capitol and the FTB related to other issues not before this court. As a result of these adjustments, the revised proposed assessments are as follows:

Year	Amount
June 30, 1968	$ 42,171
June 30, 1969	$118,946
June 30, 1970	$207,677
June 30, 1971	$ 0
June 30, 1972	$ 75,527
June 30, 1973	$ 16,827
June 30, 1974	$344,185

ifornia ratio of property, payroll, and sales, to the worldwide figures for the same factors.[4]

In the course of the FTB's investigation of Capitol, demand was made upon Capitol to provide certain business records of EMI, and EMI's other subsidiaries, under the threat that Capitol's failure to comply would result in a penalty assessment. EMI informed Capitol that it would not provide some of the information demanded because, under the Official Secrets Act of the United Kingdom, some of the information (presumably information related to military contracts entered into by EMI and the British government) is not disclosable. EMI refused to provide other information, arguing that it lacked access to such information and that California lacks jurisdiction over EMI and its non-United States subsidiaries.

Capitol filed a protest with the FTB concerning the proposed assessment, which is still pending.[5] In addition, Cap-

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[4]California Revenue and Taxation Code section 25101 provides in part:

> When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the state the tax shall be measured by the net income derived from or attributable to sources within this state in accordance with the provisions of article 2 (commencing with section 25120 of this chapter). . . .

Cal. Rev. & Tax. Code § 25101. Section 25128 provides:

> All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

Cal. Rev. & Tax. Code § 25128. Sections 25129 through 25136 define and provide for the computation of the property, payroll and sales factors. Cal. Rev. & Tax. Code §§ 25129-25136.

[5]Section 25664 of the Revenue and Taxation Code provides:

> Within 60 days after mailing of each notice of additional tax proposed to be assessed the taxpayer may file with the Fran-

itol has petitioned the FTB to authorize the use of a reporting scheme other than the unitary method, as applied to the proposed assessment.[6] Subsequent to oral argument on appeal, the FTB denied that petition.[7]

Capitol filed its action in United States District Court against William Bennett, Kenneth Cory, Richard Silberman and Martin Huff ("Board Members"), individually and as members of the FTB.[8] Capitol seeks injunctive and

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chise Tax Board a written protest against the proposed additional tax, specifying in the protest the grounds upon which it is based.

Cal. Rev. & Tax. Code § 25864.

[5]Section 25137 of the Revenue and Taxation Code provides:

If the allocation and apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the Franchise Tax Board may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

a. Separate accounting;

b. The exclusion of any one or more of the factors;

c. The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

d. The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

[7]Appellees submitted a copy of the Board's resolution, dated October 21, 1981, denying Capitol's Section 25137 petition challenging the subject proposed additional assessment.

[8]Subsequent to oral argument on appeal, appellants filed a Motion for Designation of Substituted Parties, pursuant to Federal Rule of Civil Procedure 25(d). Under Federal Rule of Appellate Procedure 43(c), the substitution of public officials who have succeeded those named as parties occurs automatically. An order of substitution is unnecessary under Rule 43(c) but such an order may be entered at anytime thereunder. Upon the representations of appellants as to the present membership of the FTB and upon

declaratory relief to prevent the proposed assessment. Essentially, Capitol argues that unitary treatment of its business and that of EMI and other EMI subsidiaries is inappropriate under California law and violates the Foreign Commerce Clause of the United States Constitution, Art. I, Sec. 8, Clause 3.[9]

EMI filed its action in federal court against the identical defendants and asserts essentially the same claims as Capitol.[10] Additionally, EMI alleges that the proposed assessment on its subsidiary Capitol would negatively affect its stock holdings in Capitol. Both EMI and Capitol also seek relief from the FTB's demand that Capitol provide certain records of EMI and its foreign subsidiaries.

The Board Members filed motions to dismiss both actions. Capitol and EMI then filed motions for summary judgment. The district court treated the Board Members' motions as motions for summary judgment, pursuant to Federal Rule of Civil Procedure 56. The district court denied Capitol's and EMI's motions and granted the Board Members' motions on the ground that the Anti-Injunction Act precluded subject matter jurisdiction because a "plain, speedy and

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the non-opposition of appellees to the motion for designation of substitution, this Court hereby orders that Mary Ann Graves, Ernest J. Dronnenburg, Jr., and Gerald H. Goldberg, be substituted for Richard Silberman, William M. Bennett, and Martin Huff, as defendants-appellees in these actions, pursuant to Rule 43(c).

[9]In particular, Capitol argues that the proposed assessment is unconstitutional in view of *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 99 S.Ct. 1813, 60 L.Ed.2d 336 (1979), where the Supreme Court held that the Commerce Clause of the United States Constitution prohibited a state from imposing a nondiscriminatory *ad valorem* tax on foreign-owned instrumentalities engaged solely in international commerce.

[10]*See* note 8 *supra*.

efficient" state court remedy existed for the claims asserted by Capitol and EMI. 28 U.S.C. § 1341.[11] Capitol and EMI appeal from that order.

II

Section 1341 provides that "district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under state law where a plain, speedy and efficient remedy may be had in the courts of such State." 28 U.S.C. § 1341.[12] This statute has its roots in equity prac-

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[11]Appellees also contend that the present actions are barred from being brought in federal court by the Eleventh Amendment.

A court should not pass upon a constitutional question, although properly presented by the record, if there is also present a statutory ground upon which the case may be disposed of. *See generally, Wood v. Strickland*, 420 U.S. 308, 95 S.Ct. 992, 43 L.Ed.2d 214 (1975). This principle has varied application, *id.*, and presumably applies where two grounds are presented for defeating subject matter jurisdiction. *See generally* 1 *Moore's Federal Practice* ¶ 0.60[3], at 620-21 (2d ed. 1980). Thus, this court should first consider whether the district court could exercise jurisdiction notwithstanding the proscriptions of the Anti-Injunction Act. If the district court order is affirmed on this ground, this court need not reach the constitutional question presented by the Eleventh Amendment.

[12]The legislative history of Section 1341 reflects two main purposes: First, the section was aimed at eliminating the discriminatory effect on citizens of the taxing state, who can only bring their tax disputes before state courts, while out-of-state corporations could take their disputes into either federal or state court. *See Aluminium Co. of America v. Dept. of Treasury of the St. of Mich.*, 522 F.2d 1120, 1123-24 (6th Cir. 1975); S. Rep. No. 1035, 75th Cong., 1st Sess. 1-2 (1937). Second, the section was intended to eliminate the disruption of state financing efforts by out-of-state corporations. *Id.; see Perez v. Ledesma*, 401 U.S. 82, 128 n.17, 91 S.Ct. 674, 698 n.17, 27 L.Ed.2d 701 (1971) (Brennan, J., concurring in part and dissenting in part); *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293, 298, 63 S.Ct. 1070, 1073, 87 L.Ed. 1407 (1943) (*"Great Lakes"*).

The Congressional Record indicates two secondary reasons behind the enactment of Section 1341. First, Congress was concerned

tice, in the principles of federalism, and in recognition of the need of a state to administer its own fiscal operations. *Tully v. Griffin, Inc.*, 429 U.S. 68, 73, 97 S.Ct. 219, 222, 50 L.Ed.2d 227 (1976); *Great Lakes Dredge & Dock Co. v. Huffman*, 319 U.S. 293, 298, 63 S.Ct. 1070, 1073, 87 L.Ed. 1407 (1943) (*"Great Lakes"*). This court has held that Section 1341 also generally bars actions for declaratory relief against the assessment or collection of state taxes. *See Housing Authority of the City of Seattle v. State of Washington*, 629 F.2d 1307, 1310 (9th Cir. 1980);[18] *see also Great Lakes*, 319 U.S. at 300, 63 S.Ct. at 1074. The jurisdictional bar of Section 1341 is not avoided by challenging the constitutionality of the state statute that authorizes the subject assessment or collection. *Mandel v. Hutchinson*, 494 F.2d 364, 366 (9th Cir. 1974) *citing Matthews v. Rodgers*, 284 U.S. 521, 525-26, 52 S.Ct. 217, 219, 76 L.Ed. 447 (1932). The issue here is whether California affords Capitol and EMI a "plain, speedy and efficient" remedy.

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IV

We now turn to the question of whether EMI has an adequate state court remedy.

The administrative procedures and refund suit provided by California law are remedies available only to taxpayers.

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with the added expense of litigating in federal courts that might make it financially unsound for state or local taxing authorities to contest a wealthy corporation's tax liability *See Aluminium Co. of America*, 522 F.2d at 1124, *citing* 81 Cong. Rec. 1416-17 (1937). Second, Congress intended to relieve the congestion in the federal courts by letting state courts settle what were viewed as essentially state controversies. *Id.*

[18] *Accord Aluminum Co. of America*, 522 F.2d 1120; *City of Houston v. Standard-Triumph Motor Co.*, 347 F.2d 194 (5th Cir. 1965), *cert. denied*, 382 U.S. 974 (1966); *Hemsley v. City of Detroit*, 320 F.2d 476, 478 (6th Cir. 1963).

Capitol, and not EMI, is the only California taxpayer involved in this controversy. Therefore, California does not provide EMI with an administrative or judicial remedy to challenge tax assessments.

The district court, however, concluded that EMI's interests in opposing the subject assessment are "identical or substantially identical to that of [Capitol], which does have access to the state administrative agencies and state courts." Thus, the court found the appellants' interests "being identical," EMI has "in effect a plain, speedy and efficient state remedy as to the matters for which it complains." The district court therefore also granted summary judgment in favor of the Board Members and against EMI.

The claims of Capitol and EMI are substantially the same. Both seek to have the Board Members enjoined from imposing the subject assessment and from demanding EMI's business records. The interests of the two corporations, however, are not necessarily identical. Although EMI contends that the proposed assessment would, in effect, constitute a tax on its non-United States business income and that of its other foreign subsidiaries, it is Capitol that would directly have to pay the assessment. Thus, while the harm that Capitol seeks to avoid is the payment of an additional assessment, EMI seeks to avoid a more indirect harm: the diminished return on and value of its stockholdings in its subsidiary corporation, Capitol.[30]

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[30]With respect to the EMI records demanded by the FTB, the interests of the two corporations are not identical. It is clear from the record on appeal that the demand for the subject records was addressed to Capitol and not to EMI. Capitol claims that it lacks access to the records, which it needs in order to succeed in its state administrative and judicial proceedings. EMI argues that its disclosure of some of the records would violate the Official Secrets

No authority has been presented for the proposition that a nontaxpayer, without state administrative or judicial remedies, is precluded under Section 1341 from maintaining an action in federal court because it has substantially similar interests and claims as a taxpayer that has such state remedies. A nontaxpayer that has stated a claim with respect to an assessment or collection is entitled to a judicial remedy in which it can participate as a party. *See Buildings & Developers Corp. v. Manassas Iron & Steel Co.*, 208 F.Supp. 485 (D.C. Md. 1962) (nontaxpayer could invoke federal jurisdiction where state remedy was available only to taxpayer); *see also D.C. Transit System, Inc. v. Pearson*, 149 F. Supp. 18 (D.D.C. 1957) (nontaxpayer could invoke federal jurisdiction), *rev'd*, 250 F.2d 765 (reversed upon reassurances that local remedies would be provided to nontaxpayer); *cf. Pool v. Wash*, 282 F. 620 (9th Cir. 1922) (nontaxpayer had standing to enjoin collection of federal taxes); *Shelton v. Gill*, 202 F.2d 503 (4th Cir. 1953) (same).[31] Because California does not provide EMI with

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Act of the United Kingdom, disclosure of other records is unwarranted because EMI is not within the taxing jurisdiction of California, and, if the records are not made available, it will be indirectly harmed by the additional tax assessment against its subsidiary.

In addition, EMI contends that the proposed assessment would violate the United States-United Kingdom Income Tax Convention because the effect of the assessment is to tax income earned by EMI outside of California, and that it is entitled to a federal court determination of that claim. Capitol, EMI argues, could only claim protection by the Convention as an incidental beneficiary. We do not address the issues raised with respect to the Convention, in view of our ruling as to Case No. 80-4114.

[31]EMI argues that the nontaxpayers in the above cited cases may have had a more direct interest in the proposed assessments at issue than does EMI. Such a distinction may be relevant in determining whether EMI has standing to assert a claim related to the assessment against Capitol or whether it has stated such a claim. The

an effective state remedy for its claims, Section 1341 does not bar the district court from exercising subject matter jurisdiction over such claims.[32]

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issue here, however, is whether a non-taxpaying entity is precluded by Section 1341 from bringing an action related to such an assessment, assuming that the entity has standing and has stated a claim.

There is serious question whether EMI, as a non-taxpayer, has standing to challenge the proposed assessment against its subsidiary corporation, Capitol, or whether it has stated a claim upon which relief can be granted. These issues, however, were not the basis for the district court's order granting summary judgment against EMI. Both issues, and any other grounds for dismissal or summary adjudication not raised on this appeal are appropriate for consideration in the first instance by the district court on remand.

The issue of standing, for example, was not raised expressly on this appeal. The issue of standing may involve factual determinations, which are appropriate for initial determination by the trial court.

Subsequent to oral argument on appeal, appellants moved for leave to file a supplemental memorandum concerning the issue of EMI's standing, We hereby deny that motion.

[32]Allowing a parent corporation to bring an action in federal district court to challenge a state tax assessment against its subsidiary corporation could result in the circumvention of state remedial procedures that Section 1341 was intended to prevent. *See* note 12 *supra*. Moreover, simultaneous federal and state actions involving substantially similar issues clearly are not desirable. California, however, could eliminate both problems by clearly providing a judicial or administrative remedy in which such non-taxpaying entities, which are interested parties and have stated a claim with respect to an assessment, could participate as parties. (Such a remedy might be particularly appropriate where the state is applying the unitary assessment method to a domestic subsidiary and its foreign parent, and where the state is demanding the business records of the foreign parent).

In addition, the problem of circumvention of state procedures and of simultaneous litigations can be minimized by the district court in many cases. For example, where appropriate the district court has authority to stay a federal proceeding brought by an interested non-taxpayer, pending a determination of state administrative and judicial proceedings brought by the taxpayer. The district court also

V

Appellees argue that if EMI's action is not precluded by Section 1341, it is barred by the Eleventh Amendment of the United States Constitution.

The Eleventh Amendment bars federal courts from hearing suits "commenced or prosecuted against one of the United States." Appellees contend that EMI's action can only be brought in federal court if the state has waived its Eleventh Amendment immunity to such an action. This argument, however, presupposes that the Eleventh Amendment would otherwise bar that action.

EMI filed its action against state officials, members of the FTB. The Eleventh Amendment does not bar federal court actions against state officials to enjoin them from enforcing unconstitutional statutes. *Ex Parte Young*, 209 U.S. 123, 28 S.Ct. 441, 52 L.Ed. 714 (1908) (injunctive action against state attorney general restraining him from enforcing state railroad rate and penalty statute). A suit against state officials is not considered a suit against the state in violation of the Eleventh Amendment where the challenged actions of the officials (1) are beyond the authority granted to them by a valid statute or (2) are performed pursuant to an unconstitutional statute. In both situations, relief can

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may dispose of actions brought by non-taxpayers, either before or after such a stay, where the non-taxpayer lacks standing, is not a real-party-in interest, or has failed to state a claim upon which relief can be granted. *See* note 31 *supra*.

We express no opinion as to whether a stay of Case No. 80-4114 is appropriate in the present circumstances. That determination is left for the Board Members to raise, if they desire, and the district court to consider in the first instance on remand. Among the factors the district court should consider in determining whether to stay such an action, is what imminent harm, if any, EMI would suffer as a result of such a stay.

be granted without interpleading the state. *See Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 689-90, 69 S.Ct. 1457, 93 L.Ed. 1628 (1949); *see, e.g., United States Steel Corp. v. Multistate Tax Commission*, 367 F.Supp. 107, 115 (S.D.N.Y. 1973), *aff'd*, 434 U.S. 452, 98 S.Ct. 799, 54 L.Ed.2d 682 (1978).

The Board Members are charged with acting unconstitutionally by applying the unitary tax method to a domestic subsidiary and its foreign parent. This case falls squarely within the doctrine of *Ex Parte Young*. In such cases, the Eleventh Amendment does not preclude access to the federal courts.

The state, however, will be deemed the real party in interest, for Eleventh Amendment purposes, if a money judgment is sought against defendants, which will have to be paid out of the state treasury. *See Edelman v. Jordan*, 415 U.S. 651, 94 S.Ct. 1347, 39 L.Ed.2d 662 (1945); *Hutchinson v. Lake Oswego School District No. 7*, 519 F.2d 961, 966 (9th Cir. 1975), *vacated on other grounds*, 429 U.S. 1033, 97 S.Ct. 725, 50 L.Ed.2d 744 (1977). Thus, a suit seeking a refund of taxes paid to a state is barred by the Eleventh Amendment even when nominally against state officials. *Ford Motor Co. v. Dept. of Treasury*, 323 U.S. 459, 65 S.Ct. 347, 89 L.Ed. 389 (1945); *Rutledge v. Arizona Board of Regents*, slip op. 5591 at 5596 (9th Cir. Nov. 12, 1981). Although the present action might result in California receiving less tax revenue, EMI seeks prospective injunctive and declaratory relief against state officials, and not a money judgment against the state. Therefore, the Eleventh Amendment is not a bar to EMI's action in fed-

eral court.[33] *Cf. Great Northern Life Insurance Co. v. Reed*, 322 U.S. 47, 64 S.Ct. 873, 88 L.Ed. 1121 (1944) (action against state tax collectors to recover monies wrongfully collected, enforceable by personal judgment); *United States Steel Corp.*, 367 F.Supp. 107 (action to enjoin application by state officials of tax law).[34]

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[33]In *Alabama v. Pugh*, 438 U.S. 781, 98 S.Ct. 3057, 57 L.Ed.2d 553 (1978), the Supreme Court ordered summary dismissal, on Eleventh Amendment grounds, of a mandatory injunction issued against the State of Alabama and the Alabama Board of Corrections, while leaving the injunction intact against officials of the state and board.

[34]The Board Members argue that if Section 1341 or the Eleventh Amendment is not a bar to Case No. 80-4114, the federal courts should abstain from ruling on the issues presented by EMI. The Board Members rely substantially on *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976) (abstention is appropriate where federal jurisdiction is invoked for purposes of restraining the collection of state taxes)."

There is little doubt that the California courts will uphold the unitary tax scheme generally as authorized by state statute. *See, e.g., California Edison Stores, Inc. v. McColgan*, 30 Cal.2d 472, 183 P.2d 16 (1974). It is unclear, however, whether the California courts would uphold the application of the unitary method in the present case. *Compare Chase Brass and Copper Co. v. Franchise Tax Board*, 10 Cal.App.3d 496, 95 Cal. Rptr. 805 (1970) (application of unitary method to foreign operations overruled) with *Firestone Tire & Rubber Co. v. Franchise Tax Board*, Los Angeles Superior Court (No. 31242 1980) (application of unitary tax method to foreign operations upheld).

It may be desirable to allow the state courts to rule on the applicability of California's unitary method in this case before the federal courts consider the constitutional issues presented. In view of this court's ruling that EMI does not have an adequate remedy in state court, however, it would be inappropriate to dismiss Case No. 80-4114 on abstention grounds. Nevertheless, the considerations relevant to the abstention argument may also be relevant to the issue of whether Case No. 80-4114 should be stayed pending a determination of Capitol's claims in state court.

VI

The order granting summary judgment in Case No. 80-4113 is vacated and the case is remanded with directions to enter an order of dismissal on grounds of lack of subject matter jurisdiction.

The order granting summary judgment in Case No. 80-4114 is reversed and the case is remanded.[33]

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[33]Subsequent to oral argument on appeal, Capitol and EMI moved to stay the proposed assessment, pursuant to Fed. R. App. P. 27(b), pending a final determination of these cases by this court or by the district court on remand. In view of our ruling with respect to Case No. 80-4113, the motion to stay is moot as to that case. Whether the proposed assessment should be stayed with respect to Case No. 80-4114 should be considered in the first instance by the district court on remand. *See* note 32 *supra*. Therefore, appellants' motion to stay the proposed assessment is denied. We express no opinion, however, as to whether the district court should grant such a stay.

Appendix C

Judicial Code Sections.

Section 1331.

(a) The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and arises under the Constitution, laws, or treaties of the United States, except that no such sum or value shall be required in any such action brought against the United States, any agency thereof, or any officer or employee thereof in his official capacity.

Section 2202.

In a case of actual controversy within its jurisdiction, except with respect to Federal taxes other than actions brought under section 7428 of the Internal Revenue Code of 1954 [26 USC § 7428], any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.

United States Constitution:

Article I, § 8, Cl. 3.

Power of Congress to regulate Commerce.

To regulate commerce with foreign nations, and among the several States, and with the Indian tribes.

Art I, Section 10, Cl 1

No State shall enter into any treaty, alliance, or confederation; grant letters of marque and reprisal; coin money;

emit bills of credit; make anything but gold and silver coin a tender in payment of debts; pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts, or grant any title of nobility.

Art I, Sec. 10, Cl 2

No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws: and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Control of the Congress.

Art I, Sec. 10, Cl 3

No State shall, without the Consent of Congress, lay any Duty of Tonnage, keep Troops, or Ships of War in time of Peace, enter into any Agreement or Compact with another State, or with a foreign Power, or engage in War, unless actually invaded, or in such imminent Danger as will not admit of delay.

Sec. 2, Cl. 2. Treaties

He shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur; and he shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consult, Judges of the Supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law:

but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Court of Law, or in the Heads of Departments.

Art I, Sec. 8, Cl. 1

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the Common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.

Art I, Sec. 8, Cl 10

To define and punish Piracies and Felonies committed on the High Seas, and Offenses against the Law of Nations.

Art III, Sec. 2, Cl 1

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority, —to all Cases affecting Ambassadors, other public Ministers and Consuls; —to all Cases of admiralty and maritime Jurisdiction; —to Controversies to which the United States shall be a Party; —to Controversies between two or more States; —between a State and Citizens of another State; —between citizens of different States, —between citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens of Subjects.

Art VI, Cl. 2

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the

United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Amendment 14 Sec. 1

. . . nor shall any State deprive any person of life, liberty, or property, without due process of law

Appendix D

Relevant Sections, United States-United Kingdom Income Tax Convention of 1946.

Article I.

(1) The taxes which are the subject of the present Convention are:

(a) In the case of the United States of America: the Federal income taxes, including surtaxes (hereinafter referred to as 'Unitd States tax');

(b) In the case of the United Kingdom of Great Britain and Northern Ireland: The income tax (including surtax), the corporation tax, and the capital gains tax (hereinafter referred to as 'United Kingdom tax').

(2) The present Convention shall also apply to any other taxes of a substantially similar character imposed by either Contracting Party subsequent to the date of signature of the present Convention by the government of any territory to which the present Convention is extended under Article XXII."

Article II.

(1) In the present Convention, unless the context otherwise requires:

(a) The term "United States means the United States of America, and when used in a geographical sense means the States, the Territories of Alaska and of Hawaii and the District of Columbia.

(b) The term "United Kingdom" means Great Britain and Northern Ireland, excluding the Channel Islands and the Isle of Man.

(c) The terms "territory of one of the Contracting Parties" and "territory of the other Contracting

Party" mean the United States or the United Kingdom as the context requires.

(d) The term "United States corporation" means a corporation, association or other like entity created or organized in or under the laws of the United States.

(e) The term "United Kingdom corporation" means any kind of juridicial person created under the laws of the United Kingdom.

(f) The terms "corporation of one Contracting Party" and "corporation of the other Contracting Party" mean a United States corporation or a United Kingdom corporation as the context requires.

(g) The term "resident of the United Kingdom" means any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for the purposes of United Kingdom tax and not resident in the United States for the purposes of United States tax. A corporation is to be regarded as resident in the United Kingdom if its business is managed and controlled in the United Kingdom.

(h) The term "resident of the United States" means any individual who is resident in the United States for the purpose of United States tax and not resident in the United Kingdom for the purposes of United Kingdom tax, and any United States corporation and any partnership created or organized in or under the laws of the United States, being a corporation or partnership which is not resident in the United Kingdom for the purposes of United Kingdom tax.

(i) The term "United Kingdom enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United Kingdom.

(j) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United States.

(k) The terms "enterprise of one of the Contracting Parties" and "enterprise of the other Contracting Party" mean a United States enterprise or a United Kingdom enterprise, as the context requires.

(l) The term "permanent establishment" when used with respect to an enterprise of one of the contracting Parties means a branch, management, factory or other fixed place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the Contracting Parties shall not be deemed to have a permanent establishment in the territory of the other Contracting Party merely because it carries on business dealings in the territory of such other Contracting Party through a *bona fide* commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting Parties maintains in the territory of the other Contracting Party a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one Contracting Party has a subsidiary corporation which

is a corporation of the other Contracting Party or which is engaged in trade or business in the territory of such other Contracting Party (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation.

* * *

Article III.

(1) Industrial or commercial profits of an enterprise of one of the Contracting Parties shall be exempt from tax by the other Party unless the enterprise is engaged in trade or business in the territory of such other Party through a permanent establishment situated therein. If such enterprise is so engaged, tax may be imposed by such Party on the industrial or commercial profits of the enterprise but only on so much of them as are directly or indirectly attributable to the permanent establishment.

(2) Where an enterprise of one of the Contracting Parties is engaged in trade or business in the territory of the other Contracting Party through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment.

Appendix E

(Appendix C to Letter of Transmittal of the Third Protocol to the Senate on April 12, 1979)

[43] APPENDIX C (to Letter)

WRITTEN RESPONSES BY WITNESSES TO QUESTIONS BY SENATORS AND COMMITTEE STAFF

Department of The Treasury
Washington, D.C.
June 8, 1979.

HON. FRANK CHURCH
Chairman,
Committee on Foreign Relations,
U.S. Senate
Washington, D.C.

DEAR MR. CHAIRMAN: To follow-up my testimony at the June 6 hearings concerning the six tax conventions or protocols involving the United Kingdom, France, Hungary and Korea, I want to assure you that Article I of the Third Protocol of the proposed US-UK Income Tax Treaty gives full effect to the Senate's reservation on Article 9(4) of that treaty. Let me also assure you that there is no similar state tax issue in any of the other five treaties which were considered by the Committee yesterday.

Again, let me emphasize our view that each of these treaties is important to the United States and that their prompt approval is desirable.

I am also enclosing answers to the written questions submitted to me by your staff at the hearings as well as copies of my answers to questions from Senator Helms and Senator Javits.

Sincerely,

DONALD C. LUBICK,
Assistant Secretary
(Tax Policy).

Enclosures.

QUESTIONS FOR ASSISTANT SECRETARY FOR TAX POLICY DONALD C. LUBICK

* * * * *

[45] Questions 6 and 7. In the third protocol proposed to the U.S.-U.K. Income Tax Treaty, the definition of permanent establishment has been changed. Please explain the basis of this change. Were the affected U.S. drilling companies contacted concerning the proposed change? If they were contacted, please give the details of when, by whom, and what resulted from such contact. Why was the permanent establishment definition selected as the item to be changed in the tax area?

Answer. In our discussions with the British subsequent to the Senate reservation on Article 9(4) of the proposed treaty, the United Kingdom specifically requested the inclusion in the protocol of a provision clarifying their taxing rights with respect to exploration and exploitation connection activities. This requested clarification was not unusual in light of the original negotiations in 1975 over the perma[46]nent establishment definition. In those negotiations, the United States agreed to delete from the twelve month permanent establishment exclusion contained in subparagraph (2)(f) of the proposed treaty any refer-

ence to "an installation of drilling rig or ship used or the exploration or development of natural resources" as a result of the British insistence that there be no limitation on their right to tax such activities. This deletion left the application of the permanent establishment definition to these activities somewhat uncertain, although as the United Kingdom authorities believe, a strong argument exists, that these activities could be taxed even without the clarification of the new protocol.

We agreed to the inclusion of this provision in the Third Protocol because it was reasonable to expect the British to request some additional concession for loss of the benefits of Article 9(4); because the terms of the provision were reasonable in light of our own statutory tax policy (we would generally tax these kinds of activities conducted in the United States, even if they were of a shorter duration than 30 days); and because it could be viewed as little more than a clarification of a reasonable interpretation taken by the British of their taxing rights under the proposed treaty without the protocol provision.

The drilling industry was clearly aware of the precise terms of the protocol provision at least one month prior to the signing of the Protocol on March 15, 1979. On February 16, 1979, Mr. Arnold W. Bramlett, Chairman of the Accounting and Taxation Committee of the International Association of Drilling Contractors (IADC), wrote to the International Tax Counsel, Mr. H. David Rosenbloom, expressing general concern over the provision. Subsequently, there were telephone conversations between Mr. Rosenbloom and Mr. Bramlett in which the Treasury sought

specific information as to the nature of the activities and the harm which was alleged would occur. These requests were confirmed in a letter from Mr. Rosenbloom to Mr. Bramlett on March 5, 1979, still 10 days before the Protocol was signed. To date, the Treasury has not received from the IADC, or any of its members, specific information detailing any specific adverse effects of the protocol provision.

THIRD PROTOCOL TO THE U.S.-U.K. INCOME TAX TREATY:

Question 1. Would you please summarize the British reaction to the reservation included in the Senate advice and consent to ratification last June 27, 1978, concerning Article 9(4).

Answer. The British tax authorities were unhappy with the Senate reservation concerning Article 9(4). They hoped that a modified version of Article 9(4) might be included in the treaty. When it became clear that there was no possibility of a modification which would be acceptable to all parties, they reluctantly agreed to seek Parliamentary approval of the treaty with the deletion of Article 9(4) but only after the Third Protocol is approved by the Senate. The British authorities view some of the provisions of the Third Protocol (particularly the North Sea permanent establishment rules) as a concession for the deletion of Article 9(4). We recently reconfirmed with the British their willingness to go forward with the treaty if the protocol is approved by the Senate.

[47] Very strong objection has been raised by the United Kingdom business community to the deletion of

Article 9(4). Many business and industrial groups in the United Kingdom have urged Parliament not to reapprove the treaty in the absence of the Article 9(4) provision.

The strength of these objections was confirmed by testimony at the June 6 hearings to the effect that there is a view among some Conservative Members of Parliament that the treaty should not be approved unless some solution can be found to the state taxation problem, albeit outside the treaty framework.

Question 2. Would any reservations added at this date jeopardize the Third Protocol and/or the US/UK Income Tax Treaty? If yes, please explain.

Answer. In our judgment any reservation on the Third Protocol, or any substantial delay in approval of the Protocol will seriously jeopardize the chances that the proposed US/UK Income Tax Treaty, with its very substantial benefits for U.S. taxpayers, will ever come into effect.

While we cannot speak for the United Kingdom, or predict with absolute certainty the actions which might be taken by the British Parliament, certain facts are clear. There is strong business opposition in the United Kingdom to the treaty reservation on Article 9(4) and as time passes there is also likely concern over the growing cost of the retroactive refund to the U.S. investors of the British Advance Corporation tax (it will be over $500 million through 1979). Despite this, the British have agreed to go forward to Parliament with the treaty as long as the U.S. Senate approves the Third Protocol containing what we, and they, view as a reasonable and justifiable provision clarifying the United Kingdom's taxing rights over certain offshore activities.

Should the United States again reserve on a treaty provision important to the British, particularly one which is reasonable in light of both the domestic tax law of the United States and the history of the basic treaty, it may well provide sufficient impetus for those in the United Kingdom opposed to the treaty to secure its defeat. Prolonged delay could have a similar effect.

* * * * *

Supreme Court, U.S.
FILED
JAN 13 1983
ALEXANDER L. STEVAS
CLERK

No. 82-903

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1982

EMI LIMITED,
Plaintiff, Appellant and Petitioner,

VS.

WILLIAM BENNETT, KENNETH CORY, MARY ANN GRAVES, AND GERALD H. GOLDBERG,
Defendants and Respondents.

On Petition for Writ of Certiorari To the United States Court of Appeals for the Ninth Circuit Prior to Entry of Decision in That Court and While Case Is Pending Therein

BRIEF FOR RESPONDENTS IN OPPOSITION

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QUESTIONS PRESENTED

Whether petitioner has standing under article III of the Constitution to bring this action.

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Defendants and Respondents.

On Petition for Writ of Certiorari To the United States Court of Appeals for the Ninth Circuit Prior to Entry of Decision in That Court and While Case Is Pending Therein

BRIEF FOR RESPONDENTS IN OPPOSITION

I

JURISDICTION

The technical jurisdictional requirements appear to be set forth adequately in the petition except that petitioner has failed to establish its standing to sue. It also should be observed that petitioner's contentions were rejected by the United States District Court for the Northern District of California based upon and in conformity with the pertinent decisions of this Court and other federal courts. Moreover, petitioner's petition to this Court prior to briefing and decision by the Ninth Circuit Court of Ap-

peals represents nothing more than a disguised attempt by a non-United States corporation, not subject to United States jurisdiction, to have this Court legislate out of existence California's unitary method of taxation.

II

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

United States Constitution, article III, section 3 (standing of plaintiff).

III

STATEMENT OF THE CASE

A. Prefatory Statement

Petitioner has completely misstated a crucial fact in the opening sentence of its "Statement of the Case," when it states that the California State tax officials seek to assess a tax against plaintiff's subsidiary "on a portion of plaintiff's income." (Petn. for Cert., p. 3.) First, the proposed assessment was made by the Franchise Tax Board of the State of California and not by any of the named defendants. Second, the proposed assessment was an assessment against petitioner's subsidiary based on the unitary method of taxation and *not an assessment on a portion of petitioner's income.*

This misstatement vividly demonstrates the complete lack of merit in petitioner's lawsuit.

B. Relevant Facts

Petitioner EMI, Limited (hereafter "EMI") is a British corporation which owns substantially all the stock of Capitol Industries-EMI, Inc. (hereafter "Capitol"),

which is a domestic corporation doing business in California.

Franchise Tax Board (hereafter "FTB") is the agency of the State of California administering the income and franchise tax laws of that state.

The named defendants are members of the FTB and the executive officer of the FTB.

FTB assessed a tax against *Capitol, not EMI*, under the unitary method.

FTB assessed no tax, did not audit and took no action against EMI, which is outside the jurisdiction of the FTB.

On August 15, 1979, EMI and Capitol filed separate lawsuits in the United States District Court against the named defendants for injunctive and declaratory relief to enjoin the said defendants from assessing a tax against Capitol.

On February 4, 1980, the District Court ordered the lawsuits of both EMI and Capitol dismissed by granting summary judgment to the named defendants; thereafter, both EMI and Capitol appealed to the Court of Appeals, Ninth Circuit.

On February 16, 1982, the Ninth Circuit Court of Appeals remanded the two cases to the district court. (681 F.2d 1107.)

Thereupon, the district court entered an order dismissing Capitol's lawsuit in accordance with the Court of Appeal's directions. Capitol then filed a petition for certiorari (No. 82-688) with this Court, which denied it on December 13, 1982. Thus, the order dismissing Capitol's lawsuit is now final.

In the case of EMI's action, EMI filed a motion for summary judgment in July 1982.

On July 30, 1982, the named defendants filed a motion to dismiss EMI's action.

On October 8, 1982, the district court granted the named defendants' motion and ordered EMI's action dismissed.

ARGUMENT

I

EMI HAS NO STANDING UNDER ARTICLE III OF THE UNITED STATES CONSTITUTION

A. Introduction

The essence of EMI's action is found in its allegation that the named defendants have unlawfully sought to assess additional taxes against Capitol on the unitary method. EMI has no quarrel with FTB's requiring Capitol to file a combined report on a unitary basis with respect to Capitol and its United States subsidiaries. But in an effort to prevent FTB from lawfully including the unitary portion of EMI's income in the tax formula to determine the amount of Capitol's income which is properly apportionable to California under the unitary method, EMI filed the instant action for injunctive and declaratory relief prior to Capitol's exhaustion of its state administrative and judicial remedies and prior to Capitol's payment of the additional taxes assessed by the FTB.

B. The Undisputed Facts Unequivocally Demonstrate That EMI Has No Standing To Sue

On the basis of the undisputed facts, it is clear that EMI has no standing to sue. The named defendants have not assessed or sought to assess any tax against EMI, nor

have they sought to take any action against EMI, which is a foreign corporation that does no business in the United States and is not a California taxpayer. EMI is only a shareholder of Capitol, the corporation which does business in California and against which the FTB assessed a tax measured by the unitary method. Because EMI has no real basis to support its standing argument, it now finds itself relying on the speculative contention that, as a shareholder of Capitol, it will suffer the possible loss of diminished dividend income or possible diminution in the value of its shares of Capitol. The premise of these contentions is fallacious.[1]

EMI is separate and independent from Capitol, the corporation against which the FTB assessed the tax. EMI occupies the status of a shareholder of Capitol. Obviously as a shareholder, EMI has no inherent right to receive anything from Capitol. It certainly does not have the right to receive monthly, quarterly, or annual or any other form of dividend. In fact, as a shareholder of Capitol, EMI owns neither the corporate property nor the corporate earnings of Capitol; it simply has an expectancy in each. This well-established proposition was stated by the United States Supreme Court in these words:

> "The owner of the shares of stock in a company is not the owner of the corporation's property. He has a right to his share in the earnings of the corporation, as they may be declared in dividends arising from the

[1]EMI also asserts that FTB demanded information of EMI threatening it with money penalties if it did not reply. (Petn. for Cert., p. 4.) However, the Ninth Circuit Court of Appeals in the initial appeal (681 F.2d 1107, 1119) stated in footnote number 30 that the FTB had sought information from Capitol, not EMI. This fact was pointed out by Judge Samuel Conti in his order below. (See Appendix A to EMI's Petn. for Cert.)

> use of all its property. In the dissolution of the corporation he may take his proportionate share in what is left, after all the debts of the corporation have been paid and the assets are divided in accordance with the law of its creation. But he does not own the corporate property." (*Rhode Island Hospital Trust Co. v. Doughton* (1926) 270 U.S. 69, 81.)

Judge Samuel Conti expanded further on this basic legal principle in the following words in the district court below:

> "Although an injury to a corporation may indirectly harm a shareholder by decreasing the value of his shares, that fact does not give the shareholder standing to sue on his own behalf. The primary injury and the primary right to sue are the corporation's; the shareholder may sue, if at all, only in a proper derivative action. *Von Brimer v. Whirlpool Corp.*, 536 F.2d 838, 846 (9th Cir. 1976); *Erlich v. Glasner*, 418 F.2d 226, 227-28 (9th Cir. 1969); *Papilsky v. Berndt*, 466 F.2d 251, 255 (2d Cir.), *cert. denied* 409 U.S. 1077 (1972); *Jensen v. Voyles*, 393 F.2d 131, 133 (10th Cir. 1968). Therefore, EMI's claim of diminution of its investment is not sufficient to confer standing." (*EMI, Ltd. v. Bennett, et al.*, No. C-79-3146 SC (D.C.N.D. of Cal.), Oct. 8, 1982, Slip Opn. p. 2; Appendix A to EMI's instant Petn. for Cert.)

Furthermore, the threatened injury to EMI is too remote and speculative to meet standing requirements. As discussed above, EMI as a stockholder has no inherent right to receive anything from Capitol. The expectant interest which EMI has in the earnings of Capitol do not entitle it to receive monthly, quarterly, annual, or any other dividends on its stockholdings. Moreover, a corporation's declaration of dividends generally is dependent not

on earnings alone, but also on such factors as corporate expansion plans, the need to increase cash reserves and the like. Thus, whether EMI will be adversely affected by proposed tax assessments against Capitol—or benefited if such assessments are held invalid—is entirely a matter of conjecture. Even if it should be ruled that the unitary tax as applied to Capitol is unconstitutional, there is absolutely no assurance that EMI will realize any concrete benefit. At this point, there are many possibilities, but one thing is certain: it is anyone's guess whether EMI will be out-of-pocket if the assessments against Capitol are sustained by the California state courts.

Finally, there is another line of authority which holds that only a corporation, and not its stockholders, can complain of an injury or wrong done to the corporation. (*Sherman v. British Leyland Motors, Ltd.* (9th Cir. 1979) 601 F.2d 429, 439-440.) An individual stockholder, even though the sole stockholder of the corporation, cannot circumvent this rule upon the theory that he has suffered individual injury because the wrong to the corporation has adversely affected the value of his stock. (*Erlich v. Glasner* (9th Cir. 1969) 418 F.2d 266; *Gentry v. Howard* (W.D. La. 1973) 365 F.Supp. 567.) This rules applies here, where EMI is claiming potential injury from proposed California tax assessments against Capitol, its American corporate subsidiary.[3]

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[3]Stockholders have been denied relief in such actions either on the ground that they lacked "standing" or that the corporation was the "real party in interest" under rule 17(a), Federal Rules of Civil Procedure. If it is found that a stockholder complaining of injury to a corporation meets the technical requirements of standing but does not satisfy the real party in interest rule, it would appear that the prohibition contained in 28 U.S.C. section 1341

Therefore, in light of the nature of EMI's interest in Capitol, EMI cannot truly show any injury. Nor can EMI show that the relief it seeks will correct the matter. Nor is an adjudication in this case necessary because Capitol will be the best proponent of its own rights regarding the applicability to it of the unitary method of taxation. Finally, there is no obstacle to Capitol asserting its rights before the California court. Moreover, Capitol can raise in the California court all of the defenses that EMI seeks to raise here, including challenges to the constitutionality of the unitary method of taxation.

C. The Most Recent United States Supreme Court Decisions Confirm That EMI Has No Standing

In the last few years there have been several major decisions involving the question of standing. However, in none of these cases has this Court expanded the standing doctrine to a person such as EMI, which was indirectly affected by some governmental action, or where the

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could still provide a basis for dismissal of actions of this kind. For example, it is clear in the present case that Capitol has a "plain, speedy and efficient" remedy in the state courts. Hence, its joinder as the real party in interest would oust this Court of jurisdiction. Morever, the recent decisions in *Fair Assessment in Real Estate v. McNary* (1981) .... U.S. .... [70 L.Ed.2d 271], *Rosewell v. LaSalle National Bank* (1981) 450 U.S. 503, reh. den. (1981) .... U.S. .... and *California v. Grace Brethren Church* (1982) .... U.S. ...., 73 L.Ed.2d 93, emphasized the strong policy against federal interference with the fiscal operations of a state. If a state provides an adequate remedy for challenge of a tax assessment, there is no apparent reason why section 1341 should not bar a federal action by an "interested nontaxpayer" as well as the taxpayer directly concerned. It is incongruous to suggest that a state can avoid the disruptive effect of federal injunctive relief in such cases by opening up its tax proceedings to interested third parties—a cure likely to be disruptive as the ailment.

directly affected person had a remedy in the state courts, or where that person was actually litigating the identical issues against the same defendant in the state courts.

The doctrine of standing was succinctly summarized in *Simon v. Eastern Ky. Welfare Rights Org.* (1976) 426 U.S. 26 [48 L.Ed.2d 450, 96 S.Ct. 1917]. This Court stated:

> "No principle is more fundamental to the judiciary's proper role in our system of government than the constitutional limitation of federal-court jurisdiction to actual cases or controversies. See *Flast v. Cohen*, 392 U.S. 83, 95, 88 S.Ct. 1942, 1950, 20 L.Ed.2d 947, 959 (1968). The concept of standing is part of this limitation. Unlike other associated doctrines, for example, that which restrains federal courts from deciding political questions, standing 'focuses on the party seeking to get his complaint before a federal court and not on the issues he wishes to have adjudicated.' *Id.*, at 99, 88 S.Ct., at 1952, 20 L.Ed.2d at 961. As we reiterated last Term, the standing question in its Art. III aspect 'is whether the plaintiff has "alleged such a personal stake in the controversy" as to warrant *his* invocation of federal court jurisdiction and to justify exercise of the court's remedial powers on his behalf.' *Warth v. Seldin*, 422 U.S. 490, 498-49, 95 S.Ct. 219, 2205, 45 L.Ed.2d 343, 354 (1975) (emphasis in original). In sum when a plaintiff's standing is brought into issue, the relevant inquiry is whether, assuming justiciability of the claim, the plaintiff has shown an injury to himself that is likely to be redressed by a favorable decision. Absent such a showing, exercise of its power by a federal court would be gratuitous and thus inconsistent with the Art. III limitation." (426 U.S. at pp. 37-38.)

In the *Eastern Ky.* case, several indigents and organizations brought suit against the Secretary of Treasury and Internal Revenue Service Commissioner, challenging a Revenue Ruling which granted favorable tax treatment to a nonprofit hospital. This Court rejected the challenge and set forth as a standing prerequisite the need for the plaintiff to show "an injury to himself that is likely to be redressed by a favorable decision." Here not only is EMI's purported injury speculative, there is absolutely no assurance of redress. Even if this Court should rule that the unitary tax as applied to Capitol is unconstitutional, there is no assurance that Capitol will declare a larger dividend to EMI or that its value in the Capitol stock will be enhanced. Moreover, in a concurring opinion, Justice Stewart expressed the applicable maxim of tax law in the following words:

> "I add only that I cannot now imagine a case, at least outside the First Amendment area, where a person whose own tax liability was not affected ever could have standing to litigate the federal tax liability of someone else." (*Id.*, at 46.)

The *Eastern Ky.* decision was cited as controlling authority in *American Soc. of Travel Agents, Inc. v. Blumenthal* (D.C. Cir. 1977) 566 F.2d 145, cert. den. (1978) 435 U.S. 947, 98 S.Ct. 1533, where it was held that an association of travel agents and individual travel agencies had no standing to complain of the failure of federal tax authorities to assess taxes on certain income received by tax-exempt organizations, even though the organizations were in competition with plaintiffs. Similarly, in *Kent v. Northern Cal. Reg. Off. of Amer. Friends Services, Com.*

(9th Cir. 1974) 497 F.2d 1325, a group of taxpayers objecting to the federal tax on telephone services placed their tax payments into a trust pending a determination of the legality of the tax. The trustee filed an interpleader action to settle adverse claims to the fund and also sought injunctive relief. Relying on the earlier opinion in *Flast v. Cohen* (1968) 392 U.S. 83 [20 L.Ed.2d 947, 88 S.Ct. 1942], the Ninth Circuit Court of Appeals held that the trustee had standing to assert an interpleader action, but had no standing to enjoin the collection of taxes from the taxpayers themselves.

The next major standing case decided by this Court was *Duke Power Co. v. Carolina Env. Study Gp.* (1978) 438 U.S. 59, where it extended standing to an environmental organization, a labor union, and a number of residents near certain planned nuclear plants. It was not difficult for this Court to find standing in *Duke Power* because the case involved "the question of whether Congress may, consistent with the Constitution, impose a limitation on liability for nuclear accidents resulting from the operation of private nuclear power plants licensed by the Federal Government." (*Id.*, at pp. 62-63.) There is no analogy between the interests of the various plaintiffs in *Duke Power*, where the threatened nuclear injury was pervasive and compensation for damages from injury would have been unconstitutionally circumscribed, and the interest of EMI, a foreign corporation, which seeks to overthrow the sovereign taxation power of the State of California.

Duke Power was followed by *Bryant v. Yellen* (1980) 447 U.S. 352, where the United States government filed a declaratory relief action to ascertain whether section 46 of a particular law applied to leased lands. There when

the district court ruled against the United States, the latter forewent an appeal of that adverse decision. Thereupon certain persons intervened to press an appeal on their own behalf because that case was the only vehicle now available to them to have determined the question of the applicability of section 46. If section 46 applied, then the intervenors would have the possibility of purchasing certain lands. This Court extended standing to the intervenors on appeal because, if they prevailed on their contention that section 46 of the law applied, they would have the possibility of purchasing the land. On the other hand, if the adverse decision was not appealed by the intervenors in light of the United States government's failure to do so, the intervenors would never have the possibility of purchasing the land.

Obviously, the facts in *Bryant v. Yellen, id.*, are completely dissimilar from those in this lawsuit. Here Capitol is capable of asserting its legal rights in the state court. To date it has pursued every possible administrative procedure available, and if it fails in those efforts, it can pay the tax and file a suit for refund in the state court.

The next case, *Maryland v. Louisiana* (1981) ..... U.S. ..... [68 L.Ed.2d 576], is *sui generis* and clearly distinguishable. There, various states sued the State of Louisiana requesting a declaration that Louisiana's "first-use" tax was unconstitutional. This Court accepted original jurisdiction and found that the plaintiff states had standing because "The plaintiff States are substantial consumers of natural gas. . . . It is clear that the plaintiff States, as major purchasers of natural gas whose cost has increased as a direct result of Louisiana's imposition of the

First-Use Tax, are directly affected in a 'substantial and real' way so as to justify their exercise of this Court's original jurisdiction." (*Id.*, at pp. 589-590.)

This Court also went on to find a second and alternate basis for standing in these words:

> "Jurisdiction is also supported by the State's interest as *parens patriae*. A State is not permitted to enter a controversy as a nominal party in order to forward the claims of individual citizens. [Citations.] But it may act as the representative of its citizens in original actions where the injury alleged affects the general population of a State in a substantial way." (*Id.*, at 590.)

This Court then pointed out another factor favoring standing, namely, that "individual consumers . . . are foreclosed from suing for refund in Louisiana's courts." (*Id.*, at p. 591.) However, in the case of EMI, not only was the tax assessed against Capitol, the latter can still file a suit for refund in the state court. This case is similar to *Arizona v. New Mexico* (1976) 425 U.S. 794, 797, where this Court refused federal standing and held:

> "[I]n the circumstances of this case, we are persuaded that the pending state-court action provides an appropriate forum in which the *issues* tendered here may be litigated." (Emphasis in original.)

Finally, very recently in its decision in *Valley Forge College v. Americans United* (1982) ..... U.S. ..... [70 L.Ed. 2d 700], this Court reiterated the rule that "[t]he exercise of judicial power . . . is . . . restricted to litigants who can show 'injury in fact' resulting from the action which they seek to have the Court adjudicate." (*Id.*, at p. 710.) This Court also made clear that "injury in fact"

must consist of something more than the invasion of an "individuated right" or "personal constitutional right" to a governmental observance of the Constitution. Rejecting the notion that mere allegation of a legal right is sufficient to confer standing, the court stated ". . . assertion of a right to a particular kind of government conduct, which the government has violated by acting differently, cannot alone satisfy the requirements of Art. III without draining those requirements of meaning." (*Id.*, at p. 717.)

The *Valley Forge* case involved a claim by citizens and taxpayers of the United States that the government's conveyance of surplus property to a college operated by a religious order violated the Establishment Clause. Clearly, no less exacting standards for determining the standing of a litigant can apply in actions brought by a foreign corporation, such as EMI, which seeks to advance the rights of its domestic subsidiary. Here the proposed assessments to which EMI objects are directed against Capitol, which is a domestic corporation doing business in California. The FTB has no jurisdiction to assert any tax or other demands against EMI and has not done so.

Stripped down to its essentials, the complaint filed by EMI shows that it is merely a concerned bystander in a pending controversy between the FTB and Capitol. It is evident that EMI has an interest in the final outcome of that controversy. This admitted interest, however, will not suffice insofar as standing is concerned. "'[T]hat concrete adverseness which sharpens the presentation of issues,' *Baker v. Carr*, 369 U.S. [186] at 204, is the anticipated consequence of proceedings commenced by one who has

been injured in fact; it is not a permissible substitute for the showing of injury itself." (*Valley Forge College v. Americans United, supra,* 70 L.Ed.2d 718.)

No palpable "injury in fact" to EMI has been alleged in this action. Its only claim is that the proposed assessments, if allowed to stand, will result in a diminution in value of its shareholding interest in Capitol.

II

THERE IS NO EXPRESS TREATY PROHIBITION AGAINST UNITIZING FOREIGN OPERATIONS

EMI contends that the treaty provisions prohibit California from employing the unitary method to foreign unitary operations. But EMI has not pointed to any provision in any treaty that expressly prohibits such. In fact, EMI admits that the treaty upon which it apparently relies "seems not to be a model of clarity." (Petn. for Cert., p. 13.) Moreover, under the "savings" clause found in all United States tax treaties, the United States retains the right to tax its citizens, residents and corporations on the basis of their worldwide income as though the treaty had not come into effect.

III

CALIFORNIA COURTS CAN AND ARE FULLY QUALIFIED TO DECIDE THE QUESTION OF THE CONSTITUTIONALITY OF THE UNITARY METHOD OF TAXATION AS APPLIED TO EMI'S UNITED STATES SUBSIDIARY

Even in this age of profligate lawsuits, this action by EMI is incredible. This is not an action involving any basic inalienable constitutional rights of a resident or citizen of the United States. Quite to the contrary. This is an

action by a foreign corporation, which is not even subject to California jurisdiction, seeking to utilize the Federal courts to judicially overthrow the sovereign taxation powers of the State of California.

If California's unitary method is as unconstitutional and illegal as EMI would have this Court believe, the California appellate and supreme courts would nullify it. After all, EMI has not furnished any evidence that the California courts are not capable of understanding the law. Nor is there any evidence that the California courts would not follow the laws as interpreted by the United States Supreme Court. Moreover, if Capitol does not have enough conviction to pursue its own direct rights in a lawsuit in the courts of the State of California, what reason is there for its shareholder, EMI, to pursue an action in the federal court in support of a speculative and indirect right?

EMI's suit is also disruptive of the entire judicial process. There are recognized principles and procedures governing challenges to state taxes. In addition, there is the proscription against multiple lawsuits. In this day when the public is clamoring for less taxes and greater government efficiency, responsible persons should seek to minimize litigation. This lawsuit completely violates these principles. There is not one valid reason for a nontaxpayer such as EMI to challenge a state tax imposed on its subsidiary when the latter has an adequate and speedy remedy in the California courts. (*Aronoff v. Franchise Tax Board* (1965) 348 F.2d 9.) Moreover, there will be utter chaos if every disgruntled taxpayer sought to attack various state tax laws in the federal courts under the guise of some purported violation of sundry provisions of the constitution.

CONCLUSION

In summary, EMI has totally failed to establish that it has standing to sue. EMI also has not pointed to the existence of a single fact, as opposed to its conjective and speculative assertions, to demonstrate that the named defendants have violated EMI's purported rights under the United States Constitution or laws. Nor has EMI cited one case which supports its contention that the FTB cannot assess a corporation doing business in California, viz., Capitol, under the unitary method. Thus, EMI's action is totally devoid of merit, and the petition should be denied.

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Respectfully submitted,

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